CIRCULAR SERIES
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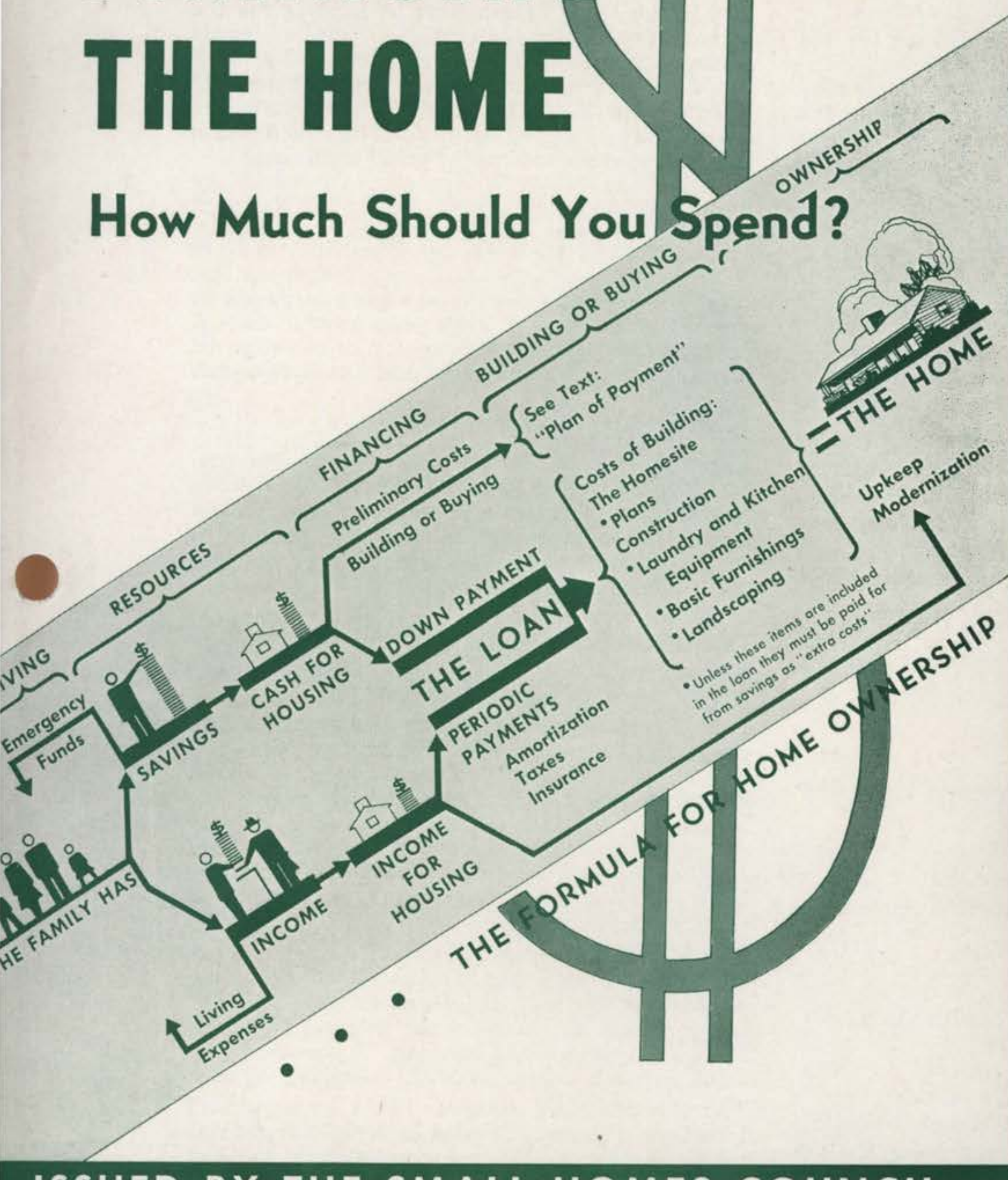
FINANCING THE HOME

How Much Should You Spend?



ISSUED BY THE SMALL HOMES COUNCIL

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HOME OWNERSHIP

For most families buying or building a home is the biggest investment of a lifetime. Before you make your plans, you must give practical consideration to all the economic factors of home ownership.

To Rent or to Own: Which is cheaper? Changes in economic conditions, interest rates and other factors sometimes favor renting, sometimes owning a home. If costs of home ownership are measured solely in dollars and cents, most people can rent living quarters for less than the cost usually incurred when they own and maintain a home.

Satisfactions of Home Ownership: Most owners find that the comfort, security, and desirable environment which come with a home of their own are worth the costs. This is especially true for families with children, where a well-knit family life and good living conditions are needed.

Personal Factors: To enjoy a home you must expect to live in it for a number of years. People who have to move frequently, or who like to travel, may find it more satisfactory to rent. Some families may enjoy living in a trailer; others want a permanent home.

The Home as an Investment: A home gives the owner an outlet for his savings which he himself manages and maintains. A house is used up just as a car or refrigerator, though not as rapidly. If the owner is careful in his investment, and keeps the property in good condition, he can figure a return in the form of rent "paid" to himself.

PLAN OF PAYMENT

Before estimating how much you should pay for a home, you have to decide on a plan of payment. Very few families have enough savings to pay for a home in a lump sum. Most people make a down payment from their savings and borrow the rest on a mortgage with their property as security. All families should retain enough cash reserve to meet emergencies such as sickness and unemployment.

PRELIMINARY AND EXTRA COSTS:

After an adequate reserve has been set aside from savings, there are certain expenses which must be investigated before the size of the down payment can be determined. Some of these must be met with cash by the owner-to-be; others should be paid by the seller. Some are included in the loan under certain lending plans; not under others. Consult your lending agency and investigate:

When Buying a Home

Preliminary Costs:

a. Appraisal fee and commission of your lending agency.

b. Revenue stamps, notary fees.

c. Recording of the mortgage.

d. Legal fees for obtaining merchantable title.

e. Pro rata insurance.

Extra Costs:

- Repair, modernization and landscaping.

When Building a Home

Preliminary Costs: same as those for buying a house, plus the following costs during the period of construction:

f. Interest on "payouts" to contractors.

g. Pro rata premium for insurance, including hazard and liability.

h. Pro rata expense for taxes on the property.

i. Inspection fees.

Extra Costs (if not included in the loan):

- Landscaping, basic furnishings, laundry and kitchen equipment.

THE DOWN PAYMENT:

After providing for the cash reserve and preliminary costs, you should make as large a down payment as is feasible. This gives you greater equity in the property and a greater margin of safety. It decreases your interest *charge* and may allow a lower interest *rate*.

THE MORTGAGE:

After making the down payment on a home, most families will borrow whatever more is necessary from a lending agency, giving a mortgage on the property as security. When building a home you should choose your lot carefully (see Small Homes Council Bulletin B2.1, "Selecting the Homesite"). *Before buying a lot, it is wise to consult your lending agency as to its suitability in location, size, and value.* Loans fall into two basic classifications: the straight mortgage and the amortized mortgage.

The Straight Mortgage: There are several types of straight loans. Practically all of them are promises to pay back definite amounts at specified future dates, and to make the interest payments at regular intervals in between. If you are interested in such a loan, consult a lending agency.

The Amortized Mortgage: With an amortized loan each payment includes both the interest due and a portion of the principal. When the last payment is made, the entire loan, as well as the interest, has been paid back. Most people will use the amortization plan in financing a home.

- **GI Loans:** The Servicemen's Readjustment Act of 1944, commonly known as the "GI Bill of Rights," provides a government guarantee for loans to eligible veterans. These loans can be made for buying, building, or modernizing a house. They will be made chiefly by local lending agencies, which, along with the Veterans' Administration, can be consulted for detailed information.

COSTS OF HOME OWNERSHIP

The costs of home ownership vary greatly and can be shown only in a general way. The figures given here will not be exact for any particular case, but they may serve as useful examples.

Amortization Costs: Most loans will run from ten to twenty years, though many agencies will let you pay off at a faster rate if you so desire. Interest rates on amortized loans vary in the United States. The table below shows amortization costs for $1000 at several different interest rates and periods of payment.

Taxes: You can find out your present tax rate from your community officials. These rates vary in different localities. Special assessments for civic improvements may be added to your tax bill.

Insurance: Lending agencies or mortgage holders require you to carry fire, wind and other hazard insurance on your property in order to protect their equity (share in the investment). Your policy should carry enough additional insurance to protect your own equity. Your local insurance agency will give you the information which relates to your case.

• *Some loan plans provide for the combined payment of amortization costs, taxes, and insurance in each scheduled installment. In any case, these costs must be met when due.*

Upkeep: On new homes, maintenance costs will be small for the first few years but they will become greater as the house grows older. Over a period of years, you will want to install improved equipment and other new conveniences as they appear on the market. When buying an older house, you should allow a greater sum for upkeep.

ILLUSTRATION OF TOTAL COSTS: Let us assume for an illustration that the costs of taxes and assessments are $18; insurance $3; and upkeep $20 per year for every $1000 of the total value of a home. The following table would then be an example of total home ownership costs per $1000 at various amortization rates (fractions omitted).

Interest Rate:	At 4 Per Cent			At 5 Per Cent			At 6 Per Cent		
Payment Period (years):	10	15	20	10	15	20	10	15	20
Cost of Amortization:	$122	$89	$73	$127	$95	$79	$133	$101	$86
Taxes and Assessments:	18	18	18	18	18	18	18	18	18
Insurance:	3	3	3	3	3	3	3	3	3
Upkeep:	20	20	20	20	20	20	20	20	20
Total Annual Costs per $1000:	$163	$130	$114	$168	$136	$120	$174	$142	$127

Amortization costs in this table are fixed according to the interest rate and the period of payment. Insurance cost is relatively constant. Costs of taxes and upkeep are variable, and may differ in your case. *They have been conservatively estimated here* because experience has shown that too many people overfinance by not allowing enough for these items. Adjustments may be made in the table where modifications are definitely known.

HOUSING COSTS AND THE FAMILY INCOME

No definite formula can be given to figure out exactly how much a family can spend for a home. However, after considering all the costs of home ownership, you can arrive at a practical estimate.

Income for Housing: Housing is one of the largest items in the family budget, and will normally take up from 20 to 30% of the income. Lower income groups spend a greater proportion of their budget for housing than do those with higher incomes. As the annual income goes up, the percentage spent for food and clothing usually decreases, leaving more to spend for housing, cars, and recreation. The following rule of thumb is often used: "You can afford a home equal to two years' income." This would require 20 to 25% of the monthly budget, and is a relatively conservative estimate.

Modifying Factors: Two families having the same income may spend entirely different amounts for housing. Factors such as stable employment, or large savings for the down payment, will enable one family making $2500 a year to spend from $6000 to $7000 for housing. Another family having the same income might spend more for a car or for vacations and entertainment, leaving less income for home ownership.

• A family with a number of dependents will have greater requirements for food, clothing, and medical care, and often will have less remaining for housing. Sometimes, however, large families make greater use of the home for recreation, and can budget more for housing than can a small family which is "never at home."

• Some people can reduce maintenance costs by doing much of the work themselves. Their costs of home ownership are less, and they can finance a larger loan. Others neglect the maintenance of their home in order to stay within an over-optimistic budget. This will lead to greater costs later, and is not a wise economy.

The Family Budget: When all items in the family budget are considered, you can see that the rule of thumb, "twice your annual income," is very general. In this circular it is assumed that each family must figure its own *income for housing*. Your own budget is a safer basis for estimating the total amount you can spend for a home.

HOW MUCH SHOULD YOU SPEND FOR A HOME?

If you can plan a family budget and fill in the blanks below, you will arrive at a practical estimate of the amount which you can spend for a home. The costs can be figured either monthly or yearly.

Food and Clothing................$________

Utilities and Fuel................ ________

Medical Care...................... ________

Life Insurance.................... ________

Other Necessary Family Expenses.. ________

Recreation .... ________

Car............................... ________

Total Living Expense..............$________

Total Income ....$________

Minus Income-tax and
Retirement Benefits............... ________

Total Net Income................ ________

Minus Total Living Expense....... ________

★INCOME FOR HOUSING........$________

The table below includes all but preliminary costs of housing. It is figured on the basis of the "Illustration of Total Costs" on page 3. To use the table, find your own "**Income for Housing**" in either the monthly or the yearly column below. Then read across to the vertical column which gives the terms of your loan. The figure arrived at will be approximately the value of the home which you can afford. Your "**Income for Housing**" ***will*** amortize your loan and ***still pay for taxes, upkeep and insurance.*** Add to this the amount of the down payment which you can make and you will have a practical estimate of the *total property value* of the home you can afford, including house and lot.

★INCOME FOR HOUSING		VALUE OF HOME WHICH INCOME FOR HOUSING WILL FINANCE									DOWN PAY-MENT (Fill In Below)	TOTAL AMOUNT YOU CAN SPEND FOR A HOME
		At 4 Per Cent			At 5 Per Cent			At 6 Per Cent				
Monthly	Annual	10 Years	15 Years	20 Years	10 Years	15 Years	20 Years	10 Years	15 Years	20 Years		
$ 15	$ 180	$1110	$ 1380	$ 1580	$1070	$ 1320	$ 1500	$1030	$ 1270	$ 1420		
20	240	1470	1850	2110	1430	1760	2000	1380	1690	1890		
25	300	1840	2310	2630	1790	2210	2500	1720	2110	2360		
30	360	2210	2770	3160	2140	2650	3000	2070	2540	2830		
35	420	2580	3230	3680	2500	3090	3500	2410	2960	3310		
40	480	2940	3690	4210	2860	3530	4000	2760	3380	3780		
50	600	3680	4620	5260	3570	4410	5000	3450	4230	4720		
60	720	4420	5540	6320	4290	5290	6000	4140	5070	5670		
80	960	5890	7380	8420	5710	7060	8000	5520	6760	7560		
100	1200	7360	9230	10,530	7140	8820	10,000	6700	8450	9450		
125	1500	9200	11,540	13,160	8930	11,030	12,500	8620	10,560	11,810		

This table will help you to arrive at a beginning figure only. *Consult a reliable lending agency and consider your own modifying factors.* For example, if less than $20 per year per $1000 is required for upkeep, the difference may be treated as an increase in available "income for housing." *Remember that the down payment reduces amortization cost, but adds to the total value of the home.* This increases the cost of taxes, insurance and upkeep, which must be paid from income for housing. For small down payments the difference is unimportant; for large down payments it is considerable. On the basis of figures used for the table, each $100 down payment requires about $4 more *annual* income for housing to pay for taxes, insurance and upkeep on the additional property value.

EXAMPLES

1. Mr. W's budget shows $35 per month "income for housing." He has $800 for a down payment, after allowing for preliminary costs. He can get a 4% loan for 20 years. How much can he spend for a home?

Read down to *monthly income* of $35. Read across to column for *4% interest—20 years* to find $3680 which is the value of the home his income will finance. Add $800 (down payment) to $3680 to make $4480, the total value of the property which he can own and maintain.

2. Mr. H. wants to buy property selling for $10,000. He has $3300 down payment and will borrow the remainder at 5% for 10 years. How much of his income must be set aside to cover costs of ownership?

$10,000 minus $3300 equals $6700, the amount of loan required. In the table at *5% for 10 years,* a $6760 loan requires about $1100 per year, or $90 per month which must be set aside from his total net income.

However, the additional amount of "income for housing" required to pay upkeep, taxes and insurance on the value added by the down payment is $33 \times \$4 = \$132$. Total income to be set aside for housing, therefore, will be $\$1100 + \$132 = \$1232$ annually, or $100 per month. *Shorter term loans are most often used when buying a home.*

3. Mr. S. can afford to spend about $720 per year for housing. He has $1500 for a down payment, and can obtain a 6% loan over 15 years. What is the value of the property which he can afford to own? In the table, under *annual income,* locate $720. Read across to column for *6%—15 years* to find home value of $5070. Add down payment of $1500. The total property value is $6570. The additional amount of income required to support the value added by the down payment is $\$4 \times 15$, or $60 per year. His income for housing must be $780 per year, or $65 per month. *Longer term loans are most frequently used when building a home.*

RECOMMENDATIONS

1. Consult a lending agency to check your estimate after you have summarized your income for housing and have determined the amount which you can spend.

2. Do not overbuild. If you spend more for housing than your budget will support, you may have to forego necessities as well as comforts. You may even lose your property or have to sell it at a loss.